Readers ask Dr. Ken • Pay isn't keeping up
NAPM celebrates 75th • Tools that are versatile

# PurchasingWorld®

THE BUYER'S MAGAZINE

JULY 1990

# The Economic Summit

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*Take a look at:*

- *Next 6 months*
- *Next year*
- *Macro-models*
- *Global perspective*

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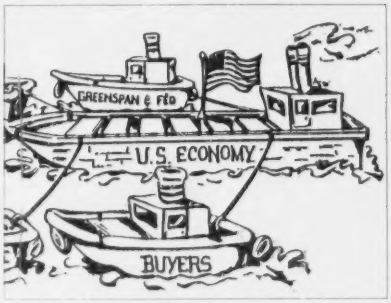


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*PurchasingWorld*

# Getting yours

Work may expand to fill the time available to do it, but there is a point at which too few heads (and hands) can never do the job properly.

That thought unfortunately is not the one expressed about the time that the next corporate turnaround is being planned by management or new ownership.

Cutting fat out is one thing. Taking muscle out is another. In the restructuring of American industry that followed the dismantling of major U.S. manufacturing corporations through leveraged buyouts, that rationale was more a reason, than reasoned.

In fact, while we are busy congratulating ourselves about how much more competitive U.S. manufacturing has become, we haven't noticed that the average work week has increased from about 32.5 hours in the early 1970s to almost 52 hours per week today. The promise or fear of a society in which leisure time is going to overwhelm the American workforce is, it would seem, at an end. Not that the idea of a 32 hour work week was such a good one in the first place.

Pick up your favorite business journal. We are proud of the wisdom and wiliness of our companies who have weathered some of the worst of times (the recessions of 1980 and 1982) and come back fighting, lean and mean. Metals companies have recovered from a downturn so precipitous that they had to look back to the Great Depression of the 1930s for a more disastrous time.

But U.S. manufacturing has become competitive for many reasons. It has invested in the latest technology. It has learned to care about quality and customers the way successful foreign competitors do. Some industries have fought for government help when they knew they were up against foreign competition subsidized by foreign governments.

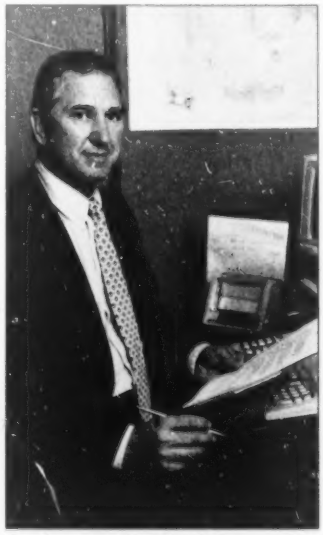
To our credit, U.S. manufacturing has rebounded in the face of odds that were lengthened by our own unchallenged dominance for so many years.

But the new skinnied and flattened-down manufacturing company has put a lot of pressure on the front line troops. Supervision and production line workers are feeling it. The impact on the depleted ranks of middle management is being documented in articles in the business press.

The purchasing department is feeling it too. According to two recent reader surveys, our purchasing readers say they are carrying a larger work load today than ever before. In spite of the fact that their departments may be more streamlined because of computerization, EDI, and office automation, they say they are understaffed for the responsibilities they carry.

Purchasing professionals are spending more of their company's dollars and handling a wider range of buying responsibilities and product categories than ever before. Their responsibilities are being expanded to other areas, such as buying services, or, as one respondent put it, even buying for an additional plant location.

And, if you hadn't guessed it, they say that their compensation has not kept pace with their increased job load.



I can't think of a better time to document purchasing department performance, especially the 10-15% reduction in purchasing expenditures that using the latest techniques of purchasing management can produce.

Purchasing departments have cut a lot of the fat out. You're leaner and meaner. Prove you're working harder and smarter.

Jim Forman

## PW PREDICTS

# Beware deceptive statistics

Gross National Product (GNP) is the market value of all goods and services produced by an economy during a specific period of time. For policymakers, it serves as an indicator of economic activity, economic well-being.

Everyone agrees that economic growth is essential for economic well-being and a rising standard of living. However, what is sometimes overlooked is that growth in excess of an optimal level is just as bad as no growth at all.

Excessive growth incites inflation, creating the boom-bust, business cycle scenario that traditionally stimulated market correction in the form of recession. The greater the boom, the greater the necessary correction. Note that it is the original acceleration in monetary growth, either actively engineered or passively permitted by the Fed, which acts as the catalyst for the boom-bust chain reaction.

By any measure, both fiscal and monetary policymakers have succeeded in keeping the current expansion going.

Under Chairman Alan Greenspan, Federal Reserve policy has primarily focused on maintaining a sustainable, noninflationary level of real GNP. Historically, this means limiting real GNP growth of 2.5%-3% per year. Real GNP accounts for price changes, thereby making this proxy for growth the direct result of differences in physical output only.

Many business people are worried that first quarter GNP and inflation levels, both higher than expected, could force further tightening by the Fed. First quarter real GNP growth was initially reported at 2.1% but has since been revised down to 1.3%. The original value was nearly twice the rate recorded in the fourth quarter of 1989. Insight suggests that when the members of the Federal Open Market Committee meet this month, they will be enlightened enough to leave policy alone, for they understand that statistics can be deceptive.

Preliminary first quarter GNP clearly signaled a rebounding economy. The figure gave no insight, however, to the duration of the rebound or the potential for an acceleration in growth. Moreover, the current figure will go through another revision, after more reliable data becomes available. Upshot 1: a closer look at first quarter GNP reveals an economy which is not as strong as the preliminary figure suggested. Upshot 2: inflation as measured by the major price indexes will subside over the next 18 months.

What is not so apparent in GNP, which records only the money spent on goods and services, is the wealth that is lost. A series of natural disasters which hit the economy in late 1989, Hurricane Hugo in September and the Bay Area earthquake in October, stimulated a higher first quarter GNP than would have otherwise occurred. Disasters are good for GNP because rebuilding inflates the total. Losses from these two disasters were never deducted from GNP or even offset against the value of new restoration. How much of the $21.7 billion increase in real GNP was the result of restoration is unclear, but it could be as high as 25 - 50%.

Measuring the performance of the economy is only slightly more important than the need for an accurate evaluation of inflation. Unfortunately, all three of the major price indexes, the consumer price index (CPI), the producer price index (PPI) and the GNP implicit price deflator exhibit internal biases, the result of their construction. To analyze inflation properly, more information is required than simply tracking each index's base number. Without knowledge of both the weight and movement of individual components included in each index, these inflation barometers can, at times, be very misleading.

This is currently the case, as early-year shocks by the heavily weighted components of food, energy and apparel skewed the indexes. In addition, the price indexes do not adjust for changes in price which result from quality improvements, nor do they compensate for substitution possibilities. The consumer price index, for example, measures the price change for a fixed basket of goods. If substitution is possible between goods, this fixed basket may not accurately reflect an individual's true cost of living.

Along with economic shocks which jeopardize an accurate analysis of the economy's rate of growth and inflation, deterioration in data collection must also be taken into consideration. Michael J. Boskin, chairman of the President's Council of Economic Advisors, has officially commented that improvements in data collection need to be made in order to provide the same degree of accuracy in today's complex economy as was provided in the past.

Skilled economists can, however, track trends relatively accurately. By analyzing the long-run tendency of economic variables and tempering this with current developments, accurate conclusions can be drawn as to which direction economic activity will gravitate.

Recognizing the need that decision-makers possess for reliable information, this issue of PurchasingWorld provides insight from leading economists, purchasing experts and econometric forecasting models on the forthcoming business environment.

*By John Sheridan*

# Gold prices are turbulent

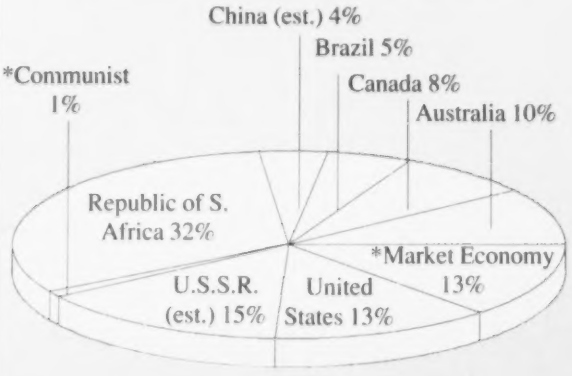
**Overview:** Gold rose over 18% from mid-September 1989 to late January 1990. In January, the price on gold per ounce stood at $425. Profit taking in March, however, stimulated a decline in gold to $389 an ounce. In the last two months, gold prices have trended further down, as Saudi Arabians have been engaging in heavy selling. In late May, an ounce of gold sold for roughly $360.

**Supply:** The rate of growth in mine production is slowing. Shearson Lehman Hutton Ltd., London, expects gold production to increase 2.6 percent through 1992, after surging 5.5 percent during the past 5 years. Production costs will keep a floor on prices. In 1989, South African production costs were roughly $285 an ounce, while production costs in the United States were approximately $225 an ounce. South Africa, the world's largest producer, could experience decreasing levels of production through 1991 due to declining grades, labor problems and lower profit margins. Production from Communist and former Communist Bloc countries will stabilize new supply, but advances are unlikely.

**Demand:** The economies of the world are slowing and are expected to remain slow through at least 1991. This situation is likely to ease jewelry purchases over the next 18 months. With inflation levels persisting in the United States and rising in Japan and Germany, gold could be looked upon favorably as a stable means of long-term investment. The industrial sector could also stimulate minor price rallies, due to changing physical demand requirements.

**Outlook:** Shearson analysts expect gold prices to average $395 an ounce in 1990, up from $381 an ounce in 1989. Their expectations are that gold prices will ascend further in 1991 and average $410 an ounce. In the very near-term, however, gold prices might drift as low as $350 an ounce, creating an excellent investment opportunity.

**World Gold Production - 1989**




Source: U.S. Department of the Interior, Bureau of Mines

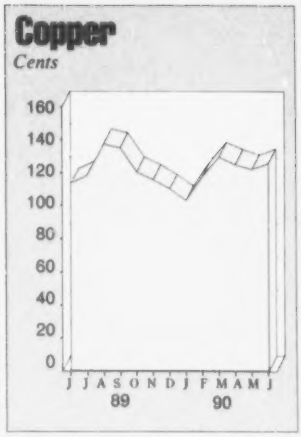
## Linerboard soft into 1991

Two factors primarily determine demand: domestic corrugated box production and linerboard export shipments. Corrugated box production has been easing since 1989 and should remain soft through at least mid-1991. Linerboard prices tend to be firmest when operating rates exceed 95%, as they did in 1987, 1988 and most of 1989. Industry operating rates are now below 95%. Moreover, massive capacity investment is arriving, which the slow-growth market can not absorb. The list price of 42 lb. kraft linerboard, which in June stood at $370-$380/ton, will drift lower unless there is a strong upturn in economic activity. Look for the price to plateau in the area of $350/ton sometime in 1991.

## Copper prices are chaotic

The price of copper has moved steadily upward in 1990. Whether it's Chile, Peru, or the Far East, labor, technical and environmental problems have produced their share of supply shocks. Moreover, demand for the metal remains strong, in a period that was expected to be lackluster at best. As a result, inventories are lean. In fact, they are near historically low levels.

This supply and demand combination has supported a more than 40% increase in prices since January, with the price now around 1.25¢/lb. Right now, copper




is clearly the most volatile of metals. The latest news release is likely to determine the metal's price for some time. Don't expect demand to weaken, so any price easing will have to be initiated from the supply side, which is chaotic at best.

## Steady increase in commercial clay

Though common clay will display growth of less than 2% annually through 1994, kaolin and fuller's earth will stimulate the industry's average demand to over 3%. According to Kimberly Kovach, an analyst at The Freedonia Group, Cleveland, kaolin will grow 7.1% per year with fuller's earth growing 6.4% yearly through 1994.

While kaolin accounts for only 19% of the industry's tonnage, it represents 65% of clay's sales value. Conversely, common clay constitutes over 65% of tonnage and less than 10% of value. Domestic demand and exports, primarily to Japan, are expected to spur kaolin price increases to $112 per ton by 1994.

# Coal still meets needs

**Overview:** Though demand might grow only moderately in 1990 and many financial wizards are viewing the coal industry with skepticism, windows of opportunity are beginning to appear. Despite the challenges presented by alternative fuel sources and additional clean air regulation, signs point to a stable market in 1990, followed by strong growth through 1995. Currently, production is rising and inventories remain low.

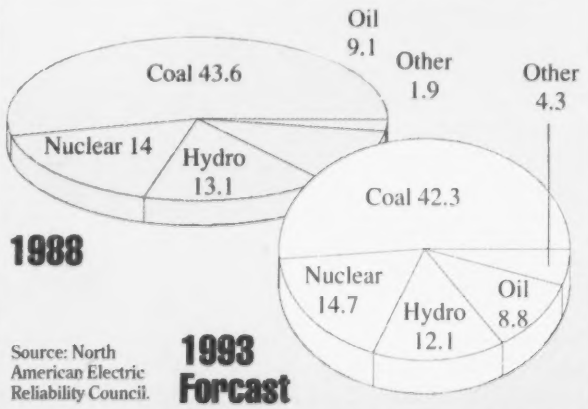
**Demand:** The electric utility sector will be the driving force behind coal demand in 1990. Supported by the relentless demand for electricity, coal production is expected to increase 2.1% this year. Growth in electricity sales to the industrial sector will increase moderately over the next 6-12 months, but manufacturing activity should rebound by mid-1991. Already raw steel production shows signs of rejuvenation.

**Supply:** Coal supplies are relatively plentiful. Historically, coal prices follow oil prices, and despite the real possibility of temporary oil shocks, coal prices are expected to remain stable through 1995. A greater threat to the price of coal comes from revisions to the Clean air amendments. Another factor, however, will be working to increase coal's market share—little increase in nuclear power is coming on-line this decade.

**Opportunities:** Environmental concerns also present opportunities. Coal cleans water and a lot of contaminants can be treated by carbon absorption. In the next ten years, water quality will be a significant issue.

German unification, along with the establishment of the European Economic Community in 1992, should end some of the existing trade barriers that domestic producers have faced overseas. The result, though the pie isn't necessarily going to grow, the U.S. share should. The U.S. Energy Information Administration anticipates that U.S. producers could gain $700 million in new European export revenue.

**Projected U.S. generating capacity, by fuel type**



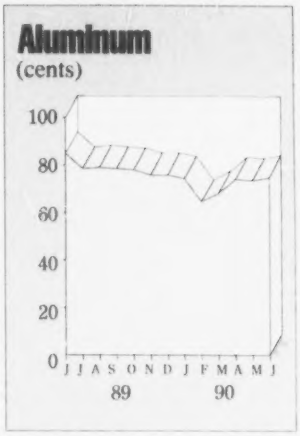

Source: North American Electric Reliability Council.

## Sulfur market shows uncertainty

Following two years of transition due to unforeseen demand fluctuations, the sulfur market is now stable. This calm could turn stormy though, as global factors unravel. Canadian material remains a concern for U.S. producers. Canada exports roughly 90% of its sulfur, which if not sent to phosphate producers in North Africa, Australia or Brazil, could enter the U.S. market, quickly driving prices down. Domestic prices have been stable, around $123/ton, since last December. Global demand is expected to begin rebounding and, propelled by increasing fertilizer consumption, should remain strong through 1993. Expect domestic tags to firm slowly as prices around the world gradually increase over the next three years.

## Aluminum firming to 85¢/lb.

Mill product orders through the first five months are in-line with that of the previous four years. The industry is solid volumewise but no upward pressure on prices is expected. Prices for ingot and scrap have been falling since last spring. In these areas, supplies are loosening and orders are slowing. Inventory increases are beginning to appear at the alumina refineries, but there has been inventory slippage by mills, despite the high production rates of




aluminum smelters. Demand is expected to continue growing moderately through year-end, supported by solid exports. With little new capacity coming on stream this year, the market will continue to gradually firm, with the average price moving towards 85¢/lb. in 1991.

## Imports to lower styrene price

The domestic styrene market is relatively tight but imports from Brazilian suppliers are beginning appear. The current domestic spot price is 47 cents per pound. Industry analysts expect imports to drive the domestic price down to 42 cents per pound by mid to late summer. Meanwhile, domestic styrene production, which had experienced operating problems, seems to be back in gear. Suppliers are beginning to build inventories. The domestic inventory increase should persist, reinforcing a movement toward lower prices.

# Purchasing in 1990/1991

Like many of us were saying, first quarter inflation numbers weren't sustainable and as the second quarter begins, the war on prices goes well. Signs clearly signal that inflation is on the run. This fact, however, is now inducing some analysts to begin talking about the next price escalation. Don't panic, commodity prices will be stable through 1991.

The analysts with one of the best track records in forecasting inflation, the WEFA Group, Philadelphia, don't expect another price surge until after the Fed achieves the soft-landing scenario it is currently working on.

For almost all industries, WEFA expects inflation to be light (0-3%) to modest (3-6%) in 1990. Three will actually show a declining rate (see chart). Stabilized or declining prices for the basic materials will quiet inflation at the finished goods level. In particular, industrial inflation will settle down with the fading of energy prices, which WEFA expects to continue downward through year-end.

Modest economic activity over the next 18 months, which is consistent with the Fed's current policy, will result in lackluster demand for many industrial materials. Prices for basic materials such as paper, steel, chemicals and plastic resins are either declining or have plateaued, reflecting their weakened demand.

WEFA noted increasing capacity, buyers keeping a closer eye on inventories, the fact that numerous companies are in the midst of implementing cost reduction strategies and foreign competition as also working to keep a lid on any price pressures which might develop.

The following is a sector by sector forecast, by the WEFA Group, on inflationary pressures for the next 12 months.

| Inflation Expectations | 12-Month Outlook |
|---|---|
| Industrial Commodities | 0-3% |
| Energy | Falling |
| Textiles and Apparel | 30-6% |
| Chemicals and Allied Products | Falling |
| Rubber and Plastic Products | Falling |
| Lumber and Wood Products | 3-6% |
| Pulp, Paper and Allied Products | 0-3% |
| Metals and Metal Products | 0-3% |
| Machinery and Equipment | 3-6% |
| Furniture and Household Durables | 3-6% |
| Nonmetallic Mineral Products | 0-3% |
| Transportation Equipment | 3-6% |

## Resin price erosion continues

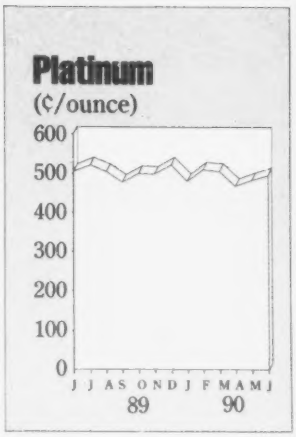
The price for injection-grade high density polyethlene (HDPE) resin has dropped again, with the spot price now around 38 c./lb. This is 4 cents below the late April price. Industry buyers commented, however, that these lower prices were primarily directed at large volume purchasers, of over 5 million pounds per year.

It appears that suppliers are simply trying to solidify relationships before price erosion makes their market highly competitive. By the third quarter, one billion pounds of new HDPE capacity will exist. This, along with traditionally weak demand in the third quarter might even create an inventory glut. By year-end, these factors will push the price for injection-grade HDPE resin into the mid to low 30 cent per pound range.

## Platinum price moving higher

In early May, rumors of a large Russian gold sell-off sent platinum prices tumbling, to as low as $470 an ounce. Currently, platinum has stabilized around $500 an ounce. A somewhat strengthening dollar is helping the metal regain lost ground but shouldn't work to push the price much higher.

Industry observers still consider palladium dealer quotes to be weak. Prices, once as low as $115 an ounce, are now near $120. This upward trend is expected to continue, possibly moving to as high as $125 an ounce by summer.




## Trouble ahead for connectors

Total shipments of U.S. circular connectors, which grew 1.6% in 1989, are expected to increase only 1% annually for the next five years. While commercial shipments will grow 5.6% annually through 1994, declining military shipments will present a significant drag on the overall industry.

## Ethylene softness to continue

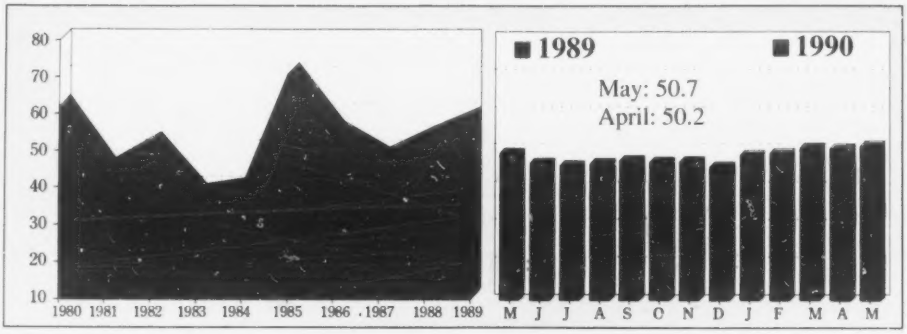
No change is expected in the market's current softness, especially with the traditionally soft third quarter now underway. While the current spot price for ethylene has droped to 14 cents per pound—down 6 cents since April—the contract price remains as it was when the year began, 24 cents per pound.

# BUSINESS DATATRAK

*by John Sheridan, chief economic editor*

## N. A. P. M. business barometer

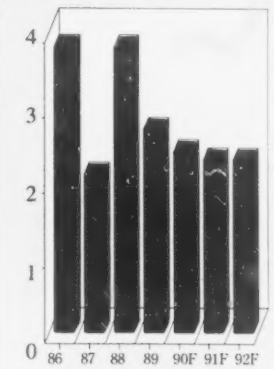
Based on five indicators (employment, inventories, new orders, production, vendor performance)




## Leading indicators

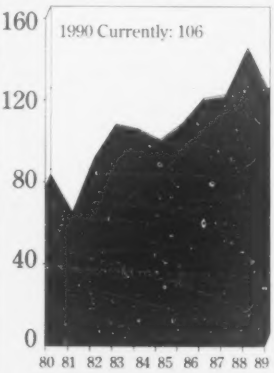
### Consumer spending

Percent change, SAAR



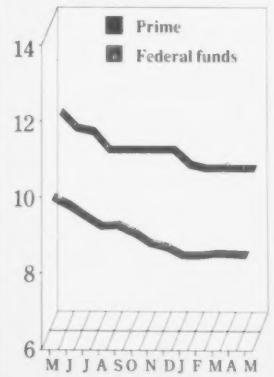

### Consumer Confidence

Index 1985 = 100




### Interest Rates

Monthly Average




Source: The Conference Board; Dept of Commerce, BEA; Board of Governors of Federal Reserve System.

## KEY ECONOMIC TRENDS

# Follow the consumer

When preliminary gross national product (GNP) for 1990 quarter one was reported in late April, some experts proclaimed that recession was no where in sight. Less than a month later, downward revision of the GNP and concern signaled by other economic beacons have confused data watchers as to which poses the greater threat, recession or inflation. Less emphasis on the most recent data releases and more analysis regarding the data's composition and trend, ease the nerves.

When economic data is scrambled, follow the consumer. Consumers play the leading role in the determination of GNP. In fact, consumer spending accounts for nearly two-thirds of total GNP.

Consumer spending has served as one of the driving forces over the past 7 1/2 years of economic expansion. Much of this increase, however, was financed by higher levels of indebtedness and lower rates of household savings. Though these factors and the slackening economy will temper any acceleration in expenditures from consumers, their spending will remain the foundation of our slow-growth scenario.

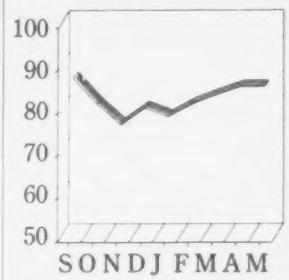
Statistically, consumers seem to be displaying caution but are certainly not retrenching. Retail sales have fallen of late but their January jump was so large that retail sales in the first quarter of 1990 were 10% higher than the level displayed in the fourth quarter of 1989. Moreover, people spend if they have money. Personal income rose in January and February, with further gains likely throughout the year. According to economists at the WEFA Group, Philadelphia, three-quarters of real GNP growth in 1990 will be fueled by consumer spending, with the majority of purchases going toward services.

The population's spending pattern is strongly influenced by the level of economic activity. Clearly, consumers aren't buying analysts selling a negative economic picture. Both The Conference Board's survey of consumer confidence and the University of Michigan's survey of consumer expectations remain at historically high levels.

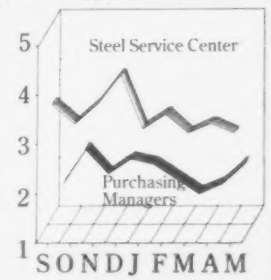
Ample statistical signs of weakness remain for the economy and aren't likely to dissipate before mid-1991. The economy is on a course of slow but sustained growth, with the consumers playing a leading role. The Fed's whole soft-landing concept is predicated on moderate

## Steel

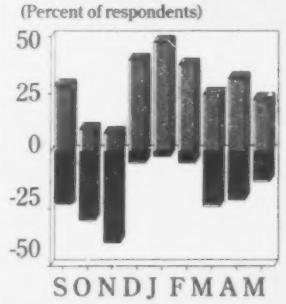
### Operating rates



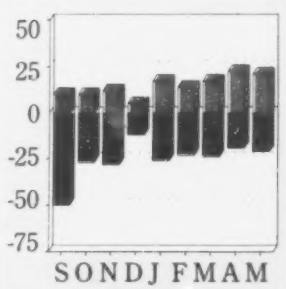

### Inventories
(months supply on hand)




### Demand (Steel Service Centers)
(Percent of respondents)




### Demand (NAP M)




Source: Steel Service Center Institute
NAPM Steel Buyers Committee

growth over an extended period of time. If people are waiting to see data suggesting an economy moving into a strong growth position, it just isn't going to happen anytime soon.

When the Federal Open Market Committee meets in Washington this month, monetary policy will probably be left unchanged. Clearly no impetus for tightening exists and the building case for a Fed ease seems premature. Inflation is retreating, according to the signs, but further evidence is needed before a change in policy is warranted.

Through its open market operations, the Fed directly affects the federal funds rate. As the anchor to which other market rates are tied, most notably the prime rate, the federal funds rate exists as a very important market beacon. A change in the federal funds rate is the most common means by which the Fed adjusts its monetary policy posture. Since late December, the federal funds rate has remained stable, with the Fed's perceived target set at 8.25%.

## STEEL SCENE

### Steel service industry continues transition

Monthly steel production remains high, with April's total set at 8.2 million tons. Reports from steel service centers show that customer activity remains better than it was in the fourth quarter of 1989, with strong optimism surrounding the second half of the year. The latest survey conducted by the Steel Service Center Institute (SSCI), Cleveland, showed 23% of its members polled anticipating an increase in orders over the next quarter. This optimism was also shared by NAPM steel buyers. The latest NAPM Steel Survey reported 21% of the buyers responding expecting an uptick in orders over the next three months.

SSCI President Andrew G. Sharkey commented that "Durable goods orders are steady, order backlogs are healthy and we have seen some declines in inventories in the durable goods sector. These factors should bode well for service centers into the third quarter."

As the steel industry's middlemen, service centers appear to be headed, even if orders remain firm, for a period of transition. Both supply and demand factors are applying some pressure to their profits.

This is especially true with regard to structural sales. Mini-mills over the past 6-9 months have been aggressive in expanding direct sales of structurals to end-users. Historically, structurals haven't required the burning, sawing or polishing—value added services that service centers specialize in—of their other products. Service centers for the most part just cut structurals to length after receiving them from the mill. As a result, mini-mills have been able to make significant inroads with direct sales.

Structural stock levels for service centers have fallen from 238,000 tons in July of 1989 to 184,000 tons in January. Industry observers believe that for service centers to regain their previous role in the structural market, they are going to have to offer something besides cutting structurals to length. Shot blasting and drilling, or even fabrication are mentioned as ways service centers might regain some of their lost market share.

On the supply side, in the face of mild demand, mills have been able to keep prices firm by not allowing the market to become flooded with steel. At the same time, major service center customers continue to try and bypass them by going right to the mills.

Automakers have made the biggest push to date in trying to eliminate them from the purchasing loop. By placing their own mill orders, automakers, most notably General Motors, have sought to gain tighter control on delivery sched-

### Import prices
(Compared to domestic)

**Steel buyers**
ABOVE 58%
SAME 28%
SLIGHTLY BELOW 14%
SUBSTANTIALLY BELOW 0%
**SERVICE CENTERS (carbon)**
ABOVE 4%
SAME 70%
5-10% BELOW 26%
10-20% BELOW 0%
OVER 20% BELOW 0%

ules and quality. The question as to whether mills will provide the same accountability on quality or achieve just-in-time delivery raises some doubt.

In the meantime, steel service centers will find it difficult to sell products at prices much higher than cost. This end-use buyers' market, excluding transitory supply shocks, should move in relation with the economy's slow-growth scenario. Expect steel prices to remain tame as long as slow growth is maintained, which right now looks to be through 1991.

Another factor with the potential to further lower prices is exports. Export possibilities are being looked upon by steel producers with great optimism. Currently, more revenue is generated from an export sale than a domestic sale. Industry exports have risen over the last five years, but they still only account for about 5% of total steel shipments. With a higher volume of exports, capacity utilization goes up and production costs go down. For the fragile steel industry, exports represent not only growth but stability as well.

## REGIONAL PERSPECTIVE

### Regions offer unique economic view

Drawing a conclusion as to the general economic health of the nation can be difficult. Worse, it can be misleading. Unlike 1982, when all of America was struggling, regional economies during the past seven years have been performing more independently. Edward Yardeni, chief economist at Prudential-Bache Securities, calls the phenomenon "the rolling recession," where downturns move from region to region, while the national economy remains stable.

The current economic condition in each of the 12 Federal Reserve districts is documented by the Board of Governors of the Federal Reserve System in what is known as the "Beigebook." The report, which is produced 10 times a year, each time by a different bank, summarizes comments received from businesses and other contacts outside the Federal Reserve System, regarding certain sectors— including manufacturing, consumer spending, financial, natural resources, real estate and construction, and agriculture—within their respective regions.

**Manufacturing:** The latest Beigebook shows a majority of the districts including Cleveland, Richmond, Atlanta, Chicago, Dallas, and San Francisco to be experiencing improvement in manufacturing activity. Most important, this increase in new orders and shipments has not been accompanied by any surge in industrial prices. And, any mention of inventories notes that they are in line with expectations.

Increasing auto production leads the rebound in the seventh district, according to the Chicago Federal Reserve Bank. Indications are that all auto facilities were in operation during late April. The worry, however, is that sales remain anemic, which raises the possibility of an inventory glut by late fall. Uncertainty surrounding upcoming labor contracts, however, might have a lot to do with the recent uptick in auto production.

**Consumer spending:** Slow but sustained growth in consumer spending, fueled by purchases in the service sector, continues. Retail sales performance is strong in Cleveland, Richmond, Minneapolis, and San Francisco, but quite weak in Dallas and St. Louis. In fact, store managers in St. Louis are openly pessimistic. This is contrary to the belief held by most retailers, who feel that, though there will be no broad-based surge in sales this year, modest gains can be expected.

Some districts noted concern that unseasonably warm weather in the first quarter may have led to early sales for some items, and thus the second quarter sales figure may suffer as a result. Supporting this theory is the strong performance of apparel, whose earlier-than-usual introduction, along with the weather, stimulated a strong early-year showing.

Though data implies that retail inventory-to-sales ratios are high, retailers maintain that inventories are in line with projected sales. Durable goods, such as furniture, appliances and other household items, are still creeping along, and will test retailers assessment of inventories.

**Natural resources:** Though oil and gas prices are lower now than they were one year ago, Dallas and Kansas City report that the drilling and exploration industry remains healthy. Mining, especially for precious metals, also remains strong according to the Minneapolis Fed.

**Real estate and construction:** The near-term consensus is that housing remains weak. Furthermore, no signs of a sustained turnaround are in sight. Pockets of strength in real estate are reported in Minneapolis-St. Paul, parts of California, and in upstate and western New York. The nonresidential market is not much better. The New York Federal Reserve Bank says that, while leasing is good in its region, significant concessions are the cause.

**Financial:** Total loan demand is flat. Only Philadelphia and St. Louis cite higher loan volume. Although every district reports some specific cases of credit tightening by banks, there seems little evidence of a system wide credit crunch. Altered lending policies include increasing collateral requirements and shorter loan terms.

## CURRENT PRICES

### Inflation on the run

The war on prices goes well. If supply shocks, principally in the food and energy sectors, remain mild, continuing moderation will persist.

The alarming first quarter inflation numbers, increasing at an annual rate of over 5%, are beginning to subside. Consumer prices in April rose a mere 0.2% while producers prices dropped 0.3%. Though it is dangerous to place too much emphasis on any single month's numbers, recent figures support the belief that first quarter inflation levels were simply an anomaly.

The April consumer price index (CPI) showed food prices falling for the first time since July of 1987. Energy prices, meanwhile, continued to descend, posting their third consecutive monthly decline. The acceleration of core inflation, which does not include food and energy prices, also appears to be over.

Another inflation barometer supports declining prices through at least mid-1991. The GNP gap is a crude summary measure of the imbalance between supply and demand in all markets within the economy. The GNP gap is the difference between actual and potential gross national product. The relationship between the GNP gap and inflation is unmistakable. A period of excess demand is signaled when real GNP grows faster than 3%, at an annual rate. When such a situation occurs, future prices rise. Conversely, if real GNP grows slower than long-run potential permits, as is currently the case, a period of falling prices can be expected. Prices will remain mild until GNP tops 3%.

### This month's breakdown

Index 1982=100

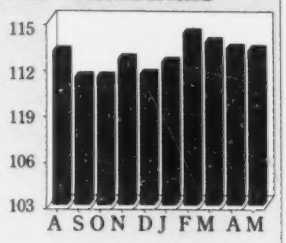
| | Latest level | % change from: month ago | year ago |
|---|---|---|---|
| Bearings | 130.2 | 0.1 | 4.9 |
| Bolts, nuts, etc. | 116.1 | 0.1 | 4.7 |
| Chemicals, inorganic | 111.5 | 0.5 | 3.5 |
| Chemicals, organic | 109.1 | -2.2 | -9.4 |
| Concrete products | 112.7 | 0.4 | 1.8 |
| Corrugated cartoons | 110.5 | -0.2 | -1.7 |
| Cutting tools, small | 113.0 | 0.1 | 3.1 |
| Electrical lamps (bulbs) | 130.5 | 0.1 | 5.7 |
| Electronic components | 118.5 | 0.1 | -0.6 |
| Fans and blowers | 122.8 | 0.2 | 4.4 |
| Foundry and forge products | 116.9 | 0.3 | 2.2 |
| Fuel oil (residual) | 51.8 | -6.2 | 9.5 |
| Furniture, commercial | 132.7 | 0.2 | 3.9 |
| Gasoline | 69.6 | 5.8 | -1.4 |
| Glass, flat | 107.8 | -0.3 | -2.0 |
| Glass containers | 120.0 | 0.4 | 2.7 |
| Gypsum products | 107.8 | 1.3 | -2.3 |
| Hand tools | 134.2 | 0.2 | 5.7 |
| Hand tools, power driven | 120.4 | 0.2 | 4.1 |
| Industrial furnaces | 126.4 | -0.3 | 1.9 |
| Integrating and measuring instruments | 126.3 | 0.4 | 7.8 |
| Internal combustion engines | 117.8 | 0.2 | 4.0 |
| Lubricating oil | 115.5 | -0.5 | 7.3 |
| Lumber millwork | 130.6 | 0.6 | 2.5 |
| Material handling equipment | 114.4 | 0.4 | 3.3 |
| Metal containers | 114.9 | 0.1 | 4.2 |
| Metal mill shapes (nonferrous) | 130.4 | 0.3 | -7.3 |
| Metal tanks | 113.9 | 0.2 | 2.9 |
| Motors and generators | 132.3 | -0.4 | 3.0 |
| Motor trucks | 130.6 | -0.1 | 1.4 |
| Office and store equipment | 110.0 | -0.6 | 1.1 |
| Paperboard | 137.8 | -0.5 | -3.2 |
| Paper boxes and shipping containers | 130.6 | -0.1 | 1.2 |
| Paper office supplies | 120.8 | -0.1 | -1.2 |
| Paint | 124.1 | 0.8 | 4.5 |
| Plastic resins | 123.2 | 0.6 | -12.4 |
| Precision measuring tools | 128.9 | 0.2 | 2.9 |
| Pumps and compressors | 118.1 | 0.3 | 3.2 |
| Refactories | 122.6 | 0.4 | 2.7 |
| Rubber belts and belting | 119.0 | -0.4 | 5.0 |
| Scales and balances | 109.0 | 0.3 | 2.6 |
| Steel products | 116.9 | 0.3 | 2.2 |
| Switchgear | 123.5 | 0.1 | 4.1 |
| Textiles, synthetic fibers | 106.6 | -0.7 | 2.4 |
| Textiles, gray fabrics | 117.3 | -0.6 | 2.9 |
| Tires and tubes | 97.3 | 0.1 | 0.1 |
| Transformers and power regulations | 120.5 | -0.1 | 3.6 |
| Welding equipment | 126.7 | 0.6 | 3.7 |
| Wire and cable | 142.4 | 1.3 | -3.7 |

### Industrial prices

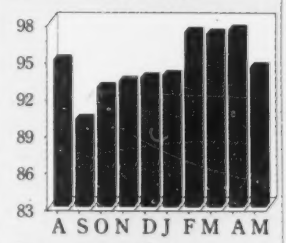
(Index: 1982=100)

■ 1988 ■ 1989

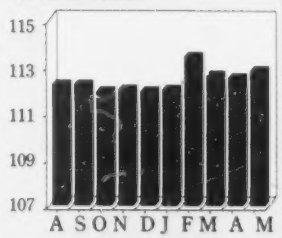
**All industrials**




**Raw materials**

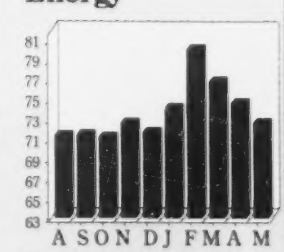



**Intermediate materials**




**Finished goods**

**Energy**




Source: Bureau of Labor Statistics

## PROCUREMENT

### Purchasers expect continued growth

Purchasers are optimistic that growth, though moderate, will be sustained through the final half of 1990. The NAPM's semiannual economic forecast, by a margin of over 4 to 1, reported purchasers believing strongly that 1990 will be the eighth consecutive year of growth.

During the first half of the year, purchasers said prices rose less than 1% since the end of 1989. Though April's NAPM Report on Business release cited a turn toward higher prices for the first time in almost one year, May's price index was once again below the 50 median (see chart). Buyers expect the average increase for the year to be less than 2%, with inflation in the second part of the year slightly higher than the first.

Moderately rising prices are to be expected, given that April signaled the first advance in 11 months for the manufacturing economy. This does not appear, however, to be a turning point toward a significant acceleration in inflation. Capacity utilization rates are good, inventories, though lean, are in line and both manufacturing and commodity inflation have edged lower during the past year.

Supporting the slow growth scenario over the next 6 months, purchasers pointed to exports and capital expenditures. The 1990 expectation for capital expenditures is growth of 8.1%, with 44% of the purchasers reporting that their companies were going to invest more in 1990 than they did in 1989. NAPM's latest index on new export orders, the other driving force, shows continued expansion anticipated for this sector.

Purchasing managers are now reporting lower prices for 17 commodities, including steel, steel bar, stainless steel plates, ethylene glycol, phenol and natural gas. Higher prices are quoted for zinc, steel scrap, bearings, caustic soda and soda ash. Commodities in short supply are bearings, electric motors, caustic soda, soda ash, hydrogen peroxide, titanium dioxide and timber.

### Powder metal healthy, growing

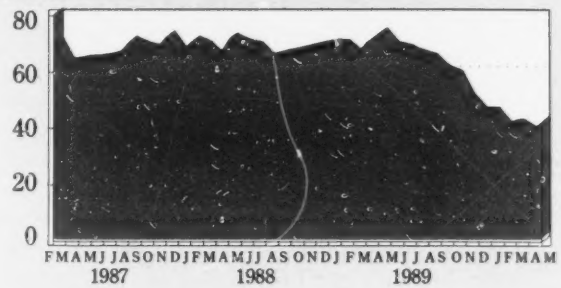
Structural changes in the powder metal (P/M) industry will find end users buying from fewer, larger, and often foreign-owned suppliers in this capital intensive industry. Driving forces include: the automotive industry, which consumes about half of the P/M industry's total output of more than one billion lb.; just-in-time manufacturing and production capability; and demands for the latest in P/M technology. Small operations are

### NAPM procurement trends

(Seasonally adjusted diffusion indexes)

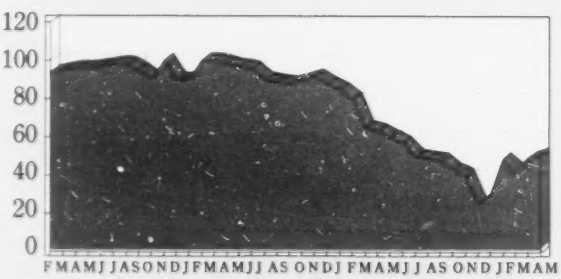
An index where 50 is defined as the neutral level, to the extent a reading is above 50, it represents an expansionary tendency. More particularly, rising inventory prices, and new orders are seen as positive signs of economic growth. A trend towards lower deliveries is similarly interpreted.

**Inventories**




**Speed of delivery**

**Price**




**New orders**

increasingly being acquired by large multipurpose suppliers.

The powder metal market is healthy, according to Leading Edge Reports, Cleveland. Powder metal consumption, in pounds, will increase at an annual rate of 7% over the next 10 years, reaching a volume of 1.4 billion lb. Dollar value will increase even faster, at a 10% per year clip, reaching almost $3.5 billion by the year 2000 compared with slightly more than $1 billion today. International trade will continue to be significant as imports represent nearly 17% of total consumption and exports represent 12% of shipments.

Key factors in P/M market growth continue to be the emergence of new applications, continued technological development, and continued strength in the metalworking and manufacturing industries. Automotive applications include structural parts produced mainly from iron, steel, and stainless steel powders, and bearings from copper and tin powders, along with cutting tools, made from tungsten carbide powders.

## Latest spot market prices

| | Latest price | Previous month | Year ago |
|---|---|---|---|
| **FERROUS METALS** | | | |
| Pig iron, basic, valley, gross ton | 213.00 | 213.00 | 213.00 |
| Pig iron, Bessemer, Pitts., gross ton | 213.00 | 213.00 | 213.00 |
| Steel, billets, Pitts., net ton | 367.00 | 367.00 | 367.00 |
| Steel, structural shapes, Pitts., cwt. | 23.90 | 23.90 | 23.90 |
| Steel, structural shapes, Chi., cwt. | 23.90 | 23.90 | 23.90 |
| Steel, structural shapes, Los Angeles, cwt. | 23.90 | 23.90 | 23.90 |
| Steel, bars, dlvd. Phila.,cwt., merchant quality | 18.70 | 18.70 | 18.70 |
| Steel, bars, Pitts., cwt. | 18.70 | 18.70 | 18.70 |
| Steel, bars, C.R., Pitts., cwt. | 23.95 | 23.95 | 25.20 |
| Steel, plates, Pitts., cwt. | 23.25 | 23.25 | 23.25 |
| Steel, plates, H.R., Pitts.,cwt. | 23.25 | 23.25 | 23.25 |
| Steel, sheets, C.R., Detroit, cwt. | 30.65 | 30.65 | 29.65 |
| Steel, strip, C.R., Chi., cwt. | 36.18 | 36.18 | 36.18 |
| Steel, basic wire, Pitts., cwt. | 23.65 | 23.65 | 23.65 |
| **NONFERROUS METALS** | | | |
| Aluminum, ingot, lb.(market place) | 0.72 | 0.75 | 0.94 |
| Antimony, N.Y., dealer, lb. | 0.87 | 0.85 | 0.99 |
| Beryllium-copper, cost ingot, lb. | 5.90 | 5.90 | 5.90 |
| Brass, red, 85%, (sheet), lb. | 1.88 | 1.88 | 2.13 |
| Brass, yellow, (sheet), lb. | 1.84 | 1.84 | 2.09 |
| Cadmium, N.Y., dealer, lb. | 4.40 | 4.40 | 7.10 |
| Copper, electrolytic, wire bars, refd., lb. | 1.26 | 1.31 | 1.50 |
| Copper sheet, over 24 in., lb. | 1.97 | 1.97 | 2.22 |
| Lead, common, N.Y., lb. | 0.45 | 0.56 | 0.35 |
| Magnesium, pig ingot, (99.8%), lb. | 1.63 | 1.63 | 1.63 |
| Mercury, 20 fl. lots, N.Y., fl. | 280.00 | 285.00 | 295.00 |
| Molybdenum, oxide, dealer, lb. | 3.35 | 3.22 | 3.72 |
| Nickel, cathode, dealer, lb. | 4.25 | 4.25 | 6.98 |
| Platinum, dealer, oz. | 492.00 | 479.00 | 523.00 |
| Silver, N.Y., oz. | 5.05 | 5.07 | 5.80 |
| Tin, N.Y., dealer, lb. | 3.03 | 3.04 | 4.40 |
| Zinc, prime west, East St. Louis, lb. | 0.87 | 0.83 | 0.90 |
| Zinc, die casting alloy, No. 3, lb. | 0.95 | 0.91 | 0.98 |
| **PAPER** (unit=ton) | | | |
| Uncoated book #3 offset | 940.00 | 940.00 | 1020.00 |
| Watermarked bond | 1090.00 | 1090.00 | 1095.00 |
| Unbleached kraft paper, grocery bag, 30 lb. | 660.00 | 660.00 | 680.00 |
| Bleached kraft, grocery bag, 30 lb. | 800.00 | 800.00 | 810.00 |
| Kraft linerboard, 42 lb., domestic, East | 370.00 | 380.00 | 380.00 |
| Newsprint, 30 lb., East | 535.00 | 535.00 | 573.00 |
| **TEXTILES** | | | |
| Burlap, 10 oz., 40", N.Y., yd. | 0.29 | 0.29 | 0.28 |
| Cotton drill, 1.85, 59", 68x49, N.Y., yd. | 1.24 | 1.24 | 1.22 |
| Cotton middling, 1", N.Y., lb. | 0.71 | 0.71 | 0.60 |
| Printcloth, 48", 80x80, N.Y., spot yd. | 0.50 | 0.50 | 0.50 |
| Army duck, 37", 13 oz., yd. | 1.49 | 1.49 | 1.50 |
| Blended printcloth, 64", 78x54, yd. | 0.76 | 0.76 | 0.75 |
| 20s combed yarns | 1.85 | 1.85 | 1.80 |
| Wool 64s, staple, lb. | 3.00 | 3.00 | 3.75 |
| **CHEMICALS** | | | |
| Acrylonitrile, tanks, lb. | 0.35 | 0.35 | 0.40 |
| Ammonia, anhydrous, tankcars, Gulf Coast, ton | 81.50 | 95.00 | 123.00 |
| Benzene, petroleum, tanks, Houston, gal. | 1.28 | 1.25 | 1.50 |
| Caustic soda, 76% solid, drums, carlots, cwt. | 28.00 | 28.00 | 28.00 |
| Cresylic acid (over 25%), tanks, lb. | 0.55 | 0.55 | 0.55 |
| Formaldehyde, USP, 37%, (12%-15% meth.),, tanks, lb. | 0.13 | 0.13 | 0.11 |
| Glycerine, synthetic, tanks, lb. | 0.80 | 0.80 | 0.79 |
| Methanol, syn., tanks, 4000 gals.,, f.o.b. Gulf Coast plants | 0.40 | 0.40 | 0.52 |
| Naphthalene, crude, tanks, lb. | 0.17 | 0.17 | 0.16 |
| Phthalic anhydride, tanks, lb. | 0.33 | 0.33 | 0.41 |
| Polyethylene resin, low density, liner film grade (market place), lb. | 0.38 | 0.38 | 0.49 |
| Polypropylene, homopolymer grade (market price), lb. | 0.50 | 0.37 | 0.46 |
| Polystyrene, general purpose grade (market price), lb. | 0.49 | 0.49 | 0.59 |
| Polyvinyl cholride, pipe grade,, (market price), lb. | 0.37 | 0.31 | 0.44 |
| Styrene monomer, 99.6%, tanks, lb. | 0.37 | 0.38 | 0.49 |
| Sulfur, crude, ex-terminal, Tampa, FL, lt. | 123.00 | 123.00 | 142.00 |
| Sulfuric acid, 66%, commercial, tanks, ton | 69.75 | 69.89 | 66.86 |
| Titanium dioxide, anatase, reg., carlots lb. | 1.02 | 1.02 | 0.95 |
| Xylene, Gulf Coast, spot, barge, gal. | 0.90 | 0.87 | 0.95 |
| **BUILDING MATERIALS** | | | |
| Lumber, 2x4 fir, mbf, cl | 354.22 | 350.78 | 326.95 |
| Lumber 2x2 pine, mbf, cl | 333.38 | 327.20 | 321.47 |
| Plywood, plyform, 3/4", msf, cl | 671.88 | 658.58 | 570.00 |
| Plywood, 5/8", msf, cl | 392.46 | 379.25 | 370.22 |
| Cement, bulk, ton, tl | 62.72 | 62.72 | 63.88 |
| Sand, ton, cl | 6.97 | 6.97 | 7.17 |
| Ready-mix concrete, 3000 psi/cu. yd. | 47.95 | 47.95 | 48.81 |
| Crushed stone, 1.5", ton, cl | 6.43 | 6.40 | 5.84 |
| Concrete blocks, sand/gravel, 8"x8"x16",, per hundred | 91.64 | 91.64 | 87.17 |
| Reinforcing bars, whse base; per cwt. | 21.88 | 21.88 | 21.32 |
| Asphalt paving AC-20 | 108.01 | 108.01 | 108.53 |
| Concrete sewer pipe, 24", prem. joint,, per ft., cl | 18.16 | 17.91 | 17.90 |
| **FUELS** | | | |
| Crude oil (W. Tx. Int. Cush), bbl. | 17.55 | 18.60 | 20.40 |
| Diesel (reseller rack, Chi.), gal. | 0.50 | 0.55 | 0.51 |
| Feul oil No. 2 (N.Y.), gal. | 0.53 | 0.58 | 0.56 |
| Fuel oil No. 2 (Gulf spot), gal. | 0.47 | 0.51 | 0.48 |
| Fuel oil No. 6 (N.Y.) contract cargo, bbl. | 18.50 | 20.50 | 18.75 |
| Gasoline (prem unlded N.Y.), gal. | 0.73 | 0.71 | 0.70 |
| Gasoline (reg unlded N.Y.), gal. | 0.64 | 0.64 | 0.59 |
| Kerosine (reseller rack, Chi.), gal. | 0.59 | 0.64 | 0.60 |
| Propane (Mt. Belvieu, TX), gal. | 0.22 | 0.24 | 0.22 |
| **SCRAP MATERIALS** | | | |
| Steel, No. 1, hvy., dlvd., Pitts., ton | 104.00 | 103.00 | 114.00 |
| Steel, No. 1 hvy., dlvd., Chi., ton | 113.00 | 110.00 | 113.00 |
| Copper, No. 1, East, wholesale buy, dlvd., lb. | 1.06 | 1.07 | 1.19 |
| Copper, No. 2, East, wholesale buy, dlvd., lb. | 0.98 | 0.97 | 1.12 |
| Brass, red, East, wholeale buy, dlvd., lb. | 1.10 | 1.10 | 1.16 |
| Brass, yellow, East, wholesale buy, dlvd., lb. | 0.63 | 0.57 | 0.61 |
| Alum., old sheet/cast, E., wholesale buy, dlvd., lb. | 0.47 | 0.51 | 0.65 |
| Alum., mixed clip., E., wholesale buy,, dlvd., lb. | 0.54 | 0.56 | 0.72 |
| Zinc, old East, wholesale buy, dlvd., lb. | 0.30 | 0.30 | 0.38 |
| Lead, clean solids, East, wholesale buy, dlvd., lb. | 0.24 | 0.24 | 0.23 |
| Paper, No. 1 mixed, dlr., N.Y., ton | Nom. | Nom. | Nom. |
| Paper, old corrug. box, dlr., Chi., ton | Nom. | Nom. | Nom. |
| Paper, old corrug. box, dlr., N.Y., ton | Nom. | Nom. | Nom. |
| Old newspapers, Chi., ton | -20.00 | -20.00 | Nom. |
| Old white ledger, Chi., ton | 75.00 | 75.00 | 75.00 |

Sources: Metals Week, American Metal Market, Engineering News-Record(20-city averages). The Wall Street Journal, Journal of Commerce, Chemical Marketing Reporter.

# Econometric models ARE REASSURING

*By John W. Sheridan*
*Chief economic editor*

Over the seven-plus years of current economic expansion the three leading econometric models have performed remarkably well, with very little variance among their relative projections. Their latest forecasts report a consensus on continued slow growth, yet diverge with respect to inflation. This conflicting view on inflation clearly signals a period of increased economic uncertainty. This uncertainty, given the slow growth of the economy, certainly increases the risk of recession, but the models foresee little chance of recession over the next 18 months.

Expect the good track record for the three models in predicting GNP to hold up. The models are optimistic that growth will continue, though at a less-than-trend pace, for the next 18 months. The average model forecast, as measured by real GNP, is for 2.2% growth in 1990 and 2.1% in 1991.

Though the models don't predict much improvement in price levels this year, the second half of 1990 will witness the beginning of a gradual descent in inflationary pressures. Moreover, this descent should continue through 1991. Price pressures, as measured by the three widely monitored indexes, would have retreated this year were it not for unforeseeable early-year shocks.

An acceleration in GNP, to above 3% annually, would change the inflation forecast. This would cause inflation to quickly heat up, since most analysts believe the current level of unemployment to be below the natural rate. Below natural-rate unemployment and above-trend GNP quickly produce both cost-push and demand-pull inflationary pressures. Such a situation would quickly force the Fed to tighten, lest they risk a period of stagflation later on.

It is unlikely, however, given a leveling off of consumer spending and consumer confidence, that GNP will exceed inflation stimulating levels. In fact, Merrill Lynch points out two factors which should work to dampen consumer spending through 1991—high debt burdens taken on in the 1980s and slower job growth. The econometric modelers believe that, though consumer spending won't propel GNP, it remains strong enough to prevent any economic downturn.

Industrial purchasing agents will be excited to learn that the models anticipate finished producer goods prices to ease significantly through 1991. Stable raw material prices along with marginal unit labor cost advances are seen as major restraining forces.

The three models expect employment levels to remain stable during the next two years. The reason: manufacturing has kept a tight control on inventories, so that any correction won't require large employment displacements. Steady employment will solidify the slow-growth, soft-landing scenario.

The major difference between the models is their respective interest rate forecast. Variance in expectations here signals uncertainty about the future course of monetary policy. While DRI and WEFA lean toward a possible Fed tightening in either the fourth quarter of 1990 or the first quarter of 1991, Merrill Lynch expects a Fed easing. Which model is correct depends on the accuracy of what's implied by current GNP data and the assumptions inherent to each model. The reassuring point is that all models expect the Fed to employ the appropriate policy for continuation of the soft-landing scenario.

Buyers can expect the current slow-growth expansion to continue into 1991. ***PW***

## The econometric models

| | 1990 | 1991 |
|---|---|---|
| **Real GNP (% change)** | | |
| DRI | 2.2 | 2.1 |
| WEFA | 2.1 | 2.2 |
| Merrill Lynch | 2.2 | 2.1 |
| AVERAGE | 2.2 | 2.1 |
| **Industrial production (% change)** | | |
| DRI | 1.6 | 2.2 |
| WEFA | 1.1 | 2.6 |
| Merrill Lynch | 1.2 | 2.4 |
| AVERAGE | 1.3 | 2.4 |
| **GNP price deflator (% change)** | | |
| DRI | 3.9 | 3.8 |
| WEFA | 4.2 | 4.0 |
| Merrill Lynch | 4.1 | 4.2 |
| AVERAGE | 4.1 | 4.0 |
| **Finished producer prices (% change)** | | |
| DRI | 3.8 | 3.4 |
| WEFA | 4.4 | 3.4 |
| Merrill Lynch | 4.3 | 3.2 |
| AVERAGE | 4.2 | 3.3 |
| **Consumer prices (% change)** | | |
| DRI | 4.7 | 4.2 |
| WEFA | 4.9 | 4.3 |
| Merrill Lynch | 5.1 | 4.3 |
| AVERAGE | 4.9 | 4.3 |
| **Prime interest rate (%)** | | |
| DRI | 10.1 | 10.8 |
| WEFA | 10.3 | 10.5 |
| Merrill Lynch | 10.0 | 9.9 |
| AVERAGE | 10.1 | 10.4 |
| **Unemployment rate (%)** | | |
| DRI | 5.3 | 5.4 |
| WEFA | 5.4 | 5.6 |
| Merrill Lynch | 5.4 | 5.4 |
| AVERAGE | 5.4 | 5.5 |